SUPREME COURT, U.S.

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No. 170

In the Supreme Court of the United States

OCTOBER TERM, 1955

GENERAL STORES CORPORATION, PETITIONER

v.

MAX SHERBET AND THE SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

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OPINIONS BELOW

The opinions of the Court of Appeals (Pet. App. 1a–11a) are reported at 222 F. 2d 234. The opinion of the District Court is reported at 129 F. Supp. 801.

JURISDICTION

The judgment of the Court of Appeals (Pet. App. 8a–9a) was entered on April 14, 1955. The petition for a writ of certiorari was filed on June 22, 1955. The jurisdiction of this Court is invoked under 28 U. S. C. 1254 (1).

QUESTION PRESENTED

Whether a corporate debtor with assets of about $5,000,000, approximately 7,000 stockholders, and over 2,000,000 shares of common stock actively traded on a national securities exchange, may utilize the arrangement procedure of Chapter XI of the Bankruptcy Act or whether it must use the corporate reorganization procedure of Chapter X.

STATUTE INVOLVED

Section 328 of the Bankruptcy Act provides:

> The judge may, upon application of the Securities and Exchange Commission or any party in interest, and upon such notice to the debtor, to the Securities and Exchange Commission, and to such other persons as the judge may direct, if he finds that the proceedings should have been brought under chapter X of this Act, enter an order dismissing the proceedings under this chapter, unless, within such time as the judge shall fix, the petition be amended to comply with the requirement of chapter X for the filing of a debtor's petition or a creditors' petition under such chapter, be filed. Upon the filing of such amended petition, or of such creditors' petition, and the payment of such additional fees as may be required to comply with section 132 of this Act, such amended petition or creditors' petition shall thereafter, for all purposes of chapter X of this Act, be deemed

to have been originally filed under such chapter. [11 U. S. C. 728; 66 Stat. 432]

STATEMENT

The order which the petitioner seeks to review affirmed an order of the District Court for the Southern District of New York granting the motions of this Commission and of Max Shlensky, a stockholder of the debtor (petitioner here), for dismissal of a petition filed by the debtor under Chapter XI of the Bankruptcy Act unless it should be amended to comply with Chapter X. (R. 2a, 3a). The Securities and Exchange Commission had been granted leave to intervene for the purpose of making the motion.

From its inception in 1915 until recently, the debtor (under its former name of D. A. Schulte, Inc.) was in the business of operating chain stores for the sale of tobacco and accessory products. New management installed in 1951 effected a change in the debtor's business in 1953 and 1954 by the purchase of the outstanding capital stock of two corporations engaged primarily in the operation of retail drug stores and by the subsequent discontinuance of the debtor's Schulte-type stores. In the five years and five months ended March 31, 1954, the debtor's aggregate losses exceeded $4,200,000 (R. 30a–32a).

The debtor's Chapter XI petition was filed on October 18, 1954. It proposed an arrangement whereunder its unsecured creditors would receive

the face amount of their claims over a five-year period. The debtor's schedules at that time listed assets of about $4,900,000 and liabilities of about $3,900,000 (R. 41a).

The debtor has outstanding 2,232,422 shares of $1 par value common stock. Of these, about 127,000 shares are owned by directors and officers, and the balance are owned by upwards of 7,000 widely scattered shareholders. The debtor's shares are listed and are actively traded on the American Stock Exchange (R. 30a). As of July 21, 1954, 596,079 of the debtor's shares had been issued pursuant to a registration statement filed in 1952 with the Securities and Exchange Commission. The major portion of the balance had previously been issued pursuant to the terms of a plan of reorganization adopted under Section 77B of the Bankruptcy Act from which reorganization the debtor emerged in 1940 (R. 30a–31a).

DISCUSSION

It is the position of the Securities and Exchange Commission that the order which petitioner asks this Court to review is correct since Congress did not intend to permit corporate debtors with securities widely held by the public to utilize the bankruptcy procedures provided by Chapter XI. Chapter X alone provides the necessary investigative and analytical procedures to deal effectively with financial and management problems of such corporations; it alone vests in

the Bankruptcy Court the necessary powers to effectuate a sound reorganization and provides the necessary protection for public investors.

Although in the present case it is argued that the proposed arrangement affects only unsecured creditors, it is obvious that it may adversely affect the public stockholders since its use, instead of Chapter X proceedings, deprives them among other things of an independent investigation by a disinterested trustee which might reveal the necessity of changes in management or plans of operation, or even that the debtors' continuation will merely postpone inevitable liquidation. In the meantime, if a Chapter XI arrangement is consummated without consideration of these matters, assets now available for public security holders may disappear and causes of action which investigation under Chapter X might disclose may be lost.

In *Securities and Exchange Commission* v. *United States Realty and Improvement Co.*, 310 U. S. 434, this Court reversed the determination of two lower courts that an arrangement under Chapter XI might be utilized by the corporation there involved, which had several classes of public investors, and held that only Chapter X could be resorted to in view of the protections for public investors there provided. This Court referred to Chapter XI as especially suited for a "small individual or corporate business where there are no public or private interests involved requiring

protection by the procedure and remedies afforded by Chapter X." (310 U. S. at 449, 454). The Court further noted that, "The basic assumption of Chapter X and other acts administered by the Commission is that the investing public dissociated from control or active participation in the management, needs impartial and expert administrative assistance in the ascertainment of facts, in the detection of fraud, and in the understanding of complex financial problems." (*Id.* fn. 6, at 448–449).

United States Realty was followed by the court below in *Mecca Temple* v. *Darrock*, 142 F. 2d 869, certiorari denied, 323 U. S. 784. That case involved a membership corporation with 2,800 members and with bonds held by 1,834 persons. The debtor was not permitted to utilize Chapter XI.

The petitioner in this case attempts to distinguish *United States Realty* and *Mecca Temple* on the ground that the public investors in those cases held debt securities whereas the public investors here are stockholders. There is nothing in the language of *United States Realty* or in its reasoning which would limit its application to publicly-held debt securities. The protective provisions of Chapter X which this Court summarized in the *United States Realty* case (310 U. S. at 449–450) are necessary to safeguard all public investors, including stockholders.

In a relatively recent case, *In the Matter of Transvision, Inc.* 217 F. 2d 243, certiorari denied, 348 U. S. 952, a panel of the court below, differing from the panel which heard the present case, upheld a district court order refusing to dismiss a Chapter XI proceeding involving a corporate debtor owned in part by public investors. The court in that case indicated that the nature of the plan and the absence of evidence of irregularities by the management made Chapter XI appropriate. The Commission believed this decision inconsistent with *United States Realty* and petitioned for certiorari, but, as indicated above, the petition was denied.[1]

We believe that the differences between this case and *Transvision, Inc.*, just mentioned, are differences in degree. Two of the judges deciding the instant case found it difficult to reconcile the decisions in the two cases, although Judge Frank apparently thought them distinguishable. We asserted in our petition in *Transvision, Inc.* that

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[1] The petitioner here cites *John Hancock Mutual Life Insurance Co.* v. *Casey*, 141 F. 2d 104 (C. A. 1), certiorari denied, 323 U. S. 713, as a case in conflict with the decision below (Pet. 9). An examination of that case, however, demonstrates that the court merely dismissed a Chapter X proceeding upon the ground that a reorganization under Chapter X was "either unnecessary or impossible." Although the court indicated that after dismissal the district court might entertain a motion to amend the petition to comply with the requirements of Chapter XI, this was not necessary to the decision.

the issue was an important one justifying review by this Court. Since the decision in that case, the question of whether Chapter X or Chapter XI was appropriate has arisen in several additional cases.

CONCLUSION

Although the Commission believes the decision of the court below is correct, because of the importance of the question involved and the possible inconsistency in the decisions of the court below, it does not oppose the granting of the petition for a writ of certiorari.

Respectfully submitted.

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